

Code of Best Practice for Corporate Governance

September 1999

Committee on Corporate Governance

FOREWORD

Corporations play a critical role---now ever growing---in the national economy. A nation's competitiveness and wealth, for that reason, depend on the competitive nature of its corporations. No doubt a transparent and reasonable governance structure bears positive impact on a company. Moreover, the issue of corporate governance structure now commands attention on the global stage.

The *Committee on Corporate Governance* was founded as a non-government body in March 1999 to develop a code of best practices, a source to guide corporations in establishing proper corporate governance structure. The Committee was composed of fourteen members from the fields of business, finance, accounting, law and academia, along with an Advisory Group of thirteen law, securities, and financial specialists.

The draft was initially drawn by three subcommittees of the Advisory Group, and revised through meetings based on opinions presented by each committee member. During its preparation, the Committee had eight meetings and the advisory, ten. The draft was circulated on August 27th via the internet and mass media, and opinions then collected through a public hearing on September 8th. The final draft, reflecting such input, reached completion on September 22nd through a general meeting of the Committee and Advisory Group.

The Committee, by endeavoring to inform all related parties of the Code of Best Practice, has been able to gather a wide range of opinions from individuals and institutions in the related areas. With appreciation for all concerns and interest expressed, every effort has been made to accommodate such opinions in the Code.

It is the high expectation of the Committee that this Code guide corporations toward improved governance structure and serve as a model of proper corporate governance structure. The Committee, therefore, has endeavored to include circumstantial contents in the Code by focusing on the practical use. At the same time, the Committee has fully attempted to take into consideration the unique managerial circumstances faced by Korean corporations, and also to include in the Code the principles and standards that are the internationally governing practices for corporations. The Committee respects the demands of the present laws and decrees while simultaneously providing a direction for exemplary corporate governance systems from a future-oriented perspective.

The Committee, however, admits that this Code may have shortcomings stemming largely from the short preparatory period allotted of six months. Also, the Code of Best Practice is evolutionary in nature and should be reviewed in light of changes in circumstances.

Lastly, the Committee expresses its gratitude to all those who participated directly or indirectly

in the making of this Code. Special gratitude is extended to the dedicated efforts of the Committee members, advisors and secretariat. Similarly, much gratitude is extended to former committee members who resigned before this Code's completion. Financial backing of the Committee has been provided by the Korea Stock Exchange, Korea Securities Dealers Association, Korea Listed Companies Association and Korea Investment Trust Companies Association. Their support is deeply appreciated.

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Jae-Chul KIM

Chairman of the Committee

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Preamble

Background

Corporations are the entities that create new economic value. And the competitiveness of businesses is crucial in determining the competitiveness of a country. As such, countries over the world are in pursuit of introducing competitive measures and practices according to international compatibility; liberalizing capital movement; and increasing the interaction between states to raise managerial efficiency and hence, enhance competitiveness of corporations of their respective nationality.

With the dawning of a new millennium, Korean corporations must also take progressive and proactive measures towards meeting the global trend to survive international competition. A faultless corporate governance system---this is a major factor in making investment decisions in the globalized capital market. For corporations to procure long-term funds under a blanket of stability, a governance structure acknowledged internationally is a must. In response to these demands of the present era, the Committee enacts this Code to present a direction for better corporate governance that will render our companies more credible, domestically and internationally, and enhance transparency and efficiency of the management.

Purpose

The purpose of the Code is to maximize corporate value by enhancing the transparency and efficiency of corporations for the future.

To gain the trust of shareholders and interested parties, the corporation must operate transparent and reliable management. Based on such corporate transparency and reliable management, a managerial system that promotes creative and progressive entrepreneurship must be established.

There are diverse stakeholders within a corporation. The corporation must decrease the burden of cost of mediating their interests; this must be achieved through a rational and fair means to strengthen the corporation's competitiveness. Also, for the corporation's long-term development, its members should make every effort in social responsibility under a strict sense of morality.

Contents and Structure of the Code

The Committee has tried, at the same time, to take into consideration of the special managerial circumstances that Korean corporations face, while also trying to include in the Code the principles and standards that are internationally accepted. Also, the Committee respects the demands of the present laws and decrees while simultaneously providing a direction for exemplary corporate governance systems from a forward looking perspective.

The contents of the Code consist of five sections and recommendations: Preamble, Shareholders, Board of Directors, Audit Systems, Stakeholders, and Management Monitoring by the Market. For each section, the code is presented, along with appended notes to aid understanding.

Application of the Code

This Code applies to listed companies and other public companies. But it is strongly advisable for non-public enterprises to also follow the Code to the extent applicable.

The circumstances surrounding each corporation are different from others and are also continuously changing; therefore, corporate governance system should be flexible and elastic. Corporations should, with the Code as its basis, voluntarily plan and operate their own corporate governance system and continuously upgrade it with ongoing evaluations. This Code should also be reviewed regularly according to changing circumstances of the time.

I. Shareholders

- **Shareholder rights shall be protected, and shareholders shall be able to exercise their rights through proper procedure.**
- **Shareholders shall be treated equitably under the principle of shareholder equality.**
- **Controlling shareholders have the corresponding responsibilities when they exercise any influence toward the corporate management other than the exercise of voting rights.**

1. Shareholder Rights

_ Shareholders shall receive all necessary information prior to exercising their rights, and shall be able to exercise their rights through proper procedure.

1.1 Shareholders, as owners of the corporation, possess basic rights including the following:

- **A right to participate in profit sharing;**
- **A right both to attend and to vote at general shareholder meetings;**
- **A right to obtain relevant corporate information in a timely and regular manner.**

As owners of the corporation, the basic rights of shareholders cannot be taken away or restricted even through the articles of incorporation, the general shareholder meetings, or the decision of the board of directors. Shareholders may participate in the corporation's profit sharing and hold residual claims, and also hold the right to attend the general shareholder meetings and exercise their voting rights. Also, shareholders hold the right to obtain relevant information on the corporation to exercise their rights; and the corporation must faithfully provide, barring any justifiable reason, any information requested by shareholders.

1.2 To protect utmost the rights of shareholders, the following matters which cause fundamental corporate changes and shareholder rights shall be decided at the general shareholder meetings.

- **Amendments to the articles of incorporation;**
- **M&A and business transfer;**
- **Corporate disbanding and dissolution;**
- **Capital reduction and others.**

It is highly desirable that shareholders be allowed to make decisions directly on issues which carry weighty influence on the corporation's very existence and the rights of shareholders. These are aside from those matters already specified for resolution at the general shareholder meetings under the current related statutes.

1.3 Resolutions from the general shareholder meeting shall be made through transparent and fair proceedings. Also, shareholders shall receive sufficient prior notice including the time, location and agenda of the meeting; such time and location shall be set so as to allow maximum number of shareholder participation.

Information shall be provided to shareholders so that sufficient review of the agenda may be made prior to the general shareholder meeting. Previously, the amount and distribution method of information provided to shareholders was limited due to the burden placed on the corporation. It is, however, now possible for corporations to provide large amounts of information at minimal cost through the internet and other electronic communication means; therefore sufficient information on the meeting's agenda shall be provided to the shareholders. Also, the time and location of the meeting shall be set such that shareholder attendance can be facilitated. Most notably, the number of minority shareholders holding shares of several different corporations has recently been on the rise; therefore, holding general shareholder meetings at different times would be judicious to maximize minority shareholder attendance.

1.4 Shareholders may submit items for the meeting agenda to the board of directors; they may question and demand explanation on the agendas at the meetings. The corporation shall ensure that shareholders' opinions are sufficiently reflected at the general shareholder meetings.

Aside from any intention to disrupt the order of the general shareholder meetings or from asking repetitious or unjustified questions, the shareholder shall be given the full capacity to sufficiently question and gain explanations prior to resolution of the agenda.

1.5 Shareholders shall be able to exercise their voting rights, either directly or indirectly, in the simplest manner possible.

The exercise of voting rights, either through direct or indirect means, has the following two implications: The first regards the exercise of one's voting right; the shareholder may exercise his voting right by participating, in person, in the general shareholder meeting, or he may exercise his voting right indirectly through a proxy. The second regards the means of exercising the voting right; the shareholder may participate in the general shareholder meeting and exercise his voting rights or may exercise his voting right through a ballot that is of written or electronic means.

In light of the considerable development in electronic communication means and the growing trend of foreign and minority shareholders, highly desired is that corporations vary the voting methods to facilitate the exercise of voting rights by shareholders.

2. Equitable Treatment of Shareholders

_Shareholders shall hold fair voting rights according to the type and number of shares possessed, and all shareholders shall equally be in possession of corporate information.

2.1 Shareholders shall hold the right to one vote per share, and there shall be no infringement on basic shareholder rights. However, voting rights for certain shareholders may be somewhat restricted as indicated by law.

The current *Commercial Code* recognizes one vote for each share for all shareholders, and the voting right is one that is inherent to the shareholder which, in principle, may not be restricted by any person.

The *Commercial Code* and certain statutes, however, allow restriction on voting exercise by certain shareholders. Justified and necessary is such to prevent adverse effects, should controlling shareholders be given unlimited exercise of voting rights.

With large corporations expanding into the financial industry, including that of investment trust business, and with the scale of investment by financial institutions in stocks and corporate bonds on the rise, the large corporation's grip on power on other corporations is similarly on the increase. To prevent any adverse effect from this development, therefore, a new form of voting right restriction shall be introduced, if considered justified.

2.2 Shareholders shall be provided all necessary information---both sufficiently and impartially---from the corporation in a timely manner, and the corporation shall not show partiality to certain shareholders by providing undisclosed information.

Shareholders need to be informed periodically of information---aside from those matters disclosed regularly---on the corporation which may have influence on its stock value. The corporation, therefore, shall make every effort to provide as much information to all shareholders impartially. In particular, the corporation shall disclose such information at its presentations to those absent shareholders and other retail investors.

2.3 Shareholders shall be protected from unfair conducts of insider trading and self-dealing.

The management or shareholders must not engage in insider trading or self-dealing with the intent of personal gains. Particularly, self-dealing must be dealt within reasonable bounds away from any breach of moral obligation by the management. For such, the corporation shall be equipped with an internal control mechanism to handle insider trading and self-dealing, and the details of such transactions shall be disclosed through a fair means.

3. Shareholder Responsibilities

_Shareholders shall make every effort to exercise their voting rights. Controlling shareholders, aside from exercising their voting rights accorded to the shares possessed, shall take corresponding responsibility whereby they exercise influence over the corporate management.

3.1 Shareholders, understanding that the exercise of their voting rights has bearing on the corporate management, shall make every effort to exercise their voting rights for the corporation's best interests.

The shareholders' exercise of voting rights is a freedom of choice. For the sound and transparent management of the corporation, however, a general shareholder must make every

effort to exercise his given rights, such as taking serious interest in the corporation's management and exercising his voting rights.

3.2 Controlling shareholders wielding influence on the corporate management shall act in the best interests of the corporation and all its shareholders. For any action running counter to such, the controlling shareholders shall bear all corresponding responsibility.

The controlling shareholder is one, regardless of his proportion of shareholding, who exercises *de facto* influence over major matters involving corporate management, such as appointment and dismissal of management.

The responsibility of running the corporation lies with its directors and management. In truth, however, it is difficult for such directors to completely reject the unequal power yielded by the controlling shareholder so long as he possesses influence over the selection of directors. Therefore, controlling shareholders---aside from exercising their voting rights on shares possessed or from directly participating in the corporate management as directors---shall accept responsibilities for their power yielded, corresponding to the influence exercised on the corporate management using their vantage position.

Any unjustified intervention in management by the controlling shareholder, contrary to the interests of the corporation, may be controlled through strengthening managerial accountability of directors and revitalizing the outside director system. However, for the controlling shareholders' influence on the corporate management---aside from exercising their voting rights or from directly participating in the corporate management as directors, it is of utmost importance that the following be understood: responsibilities they possess is proportional to their exercise of influence.

II. Board of Directors

- The Board of Directors (hereafter the “Board”) shall make the corporation’s key management policy decisions and shall supervise the activities of directors and management.
- The directors and the Board shall perform their duties faithfully in the best interests of the corporation and its shareholders; they shall also perform their social responsibilities and consider the interests of various stakeholders.
- The Board shall observe the related statutes and the articles of incorporation when performing its duties, and shall ensure that all members of the corporation also observe them.

1. Functions of the Board

_ The Board shall make the key management policy decisions in the best interests of the corporation and its shareholders, and shall perform effective supervision of the directors and management.

1.1 The Board, holding comprehensive power over the corporate management, shall perform the following functions of decision-making and management supervision:

- **Setting business goals and strategies;**
- **Approving business plans and budgets;**
- **Supervising management and evaluating management performance;**
- **Replacing the management and also reviewing the remuneration;**
- **Monitoring major capital expenditures and corporate takeover;**
- **Mediating the conflicting interests among directors, management and shareholders;**
- **Ensuring integrity of the accounting and financial reporting systems;**
- **Supervising risk management and financial control;**
- **Supervising the compliance of statutes and ethics-related regulations;**
- **Monitoring the effectiveness of governance practices;**
- **Overseeing the process of information disclosure.**

At present, the Board is designed to be the heart of corporate operations. The Board, therefore, must perform all its duties not only to protect minority shareholders and other parties of interest ---monitoring and restraining the self-validating management or controlling shareholders---but to prevent corporate insolvency. For this, the Board’s major functions and duties regarding corporate decision-making and management supervision shall be clearly stated so that its role played in corporate governance is understood.

1.2 The Board may mandate its authority to its internal committee or to the representative director. Excluded, however, are key matters as stated in the articles of

incorporation and the Board Operating Regulation.

Many corporations, especially those large, have become so specialized in their management and also so functional-oriented that they have become unsuitable for all Board members to assemble any time when an occasion arises for execution of all corporate operations. Moreover, with the sharp rise in the number of outside directors, holding Board meetings frequently has become difficult.

Therefore, to vitalize the Board's functions and to have all such functions executed, it shall be able to mandate---as long as no violation is made on the statutes and laws or the articles of incorporation---a portion of its authority to its respective internal committees or the representative director. That is, it is highly advised that the Board concentrate on key management decision-makings and mandate relatively lesser or trivial matters to the representative director or the management; or that the Board establish internal committees within itself to which a portion of the authority can be delegated.

The internal committees, composed of directors with expertise and interest in the area concerned, shall enhance the effectiveness and expertness of the duties performed by the Board through division of labor, thereby creating effective control over the management.

2. Composition of the Board

_ The Board shall be composed so as to allow effective decision-making and supervision of the management.

2.1 The number of directors shall be such that it allows the Board to have fruitful discussions and to make appropriate, swift and prudent decisions. For large public corporations, it is highly advised that the number of directors on the Board be appropriate for effectively managing internal committees.

There is no perfect number of directors appropriate for all the different circumstances of corporations. The reason lies with the many different factors that may influence the Board's size, e.g., the corporation's size, the business environment, and special characteristics. Nevertheless, the Board's size shall be such that it allows the discussions to be fruitful and the decisions made to be appropriate, swift and prudent. A large-scale public corporation is one having a total asset value of more than one trillion won.

2.2 The Board shall include outside directors capable of performing their duties independently from the management, controlling shareholders and the corporation. The number of outside directors shall be such that the Board is able to maintain practical independence. Particularly, it is recommended that financial institutions and large-scale public corporations gradually increase the ratio of outside directors to over half of the total number of directors (minimum three outside directors).

To raise transparency of corporate management and to improve corporate governance, stock-listed corporations shall appoint outside directors to fill a minimum one-quarter of the total; banks and public sector corporations, a minimum one-half.

The most important role of outside directors is to enable the Board to perform its management supervisory functions effectively. Such directors hold an independent position from the corporation, management and controlling shareholders when compared to standing directors, thereby making possible effective management supervision and objective management counseling.

For outside directors to perform their functions properly, it is important that the number of outside directors appointed is adequate for them to exercise actual influence in the Board's decision-making process. Therefore, the proportion of outside directors shall be decided at the level where the Board would be able to maintain actual independence from the management and the controlling shareholders while exercising influential authority over management decisions. For financial institutions and large-scale public corporations, particularly, the Board's management supervisory function holds much importance; it is highly advised that the ratio of outside directors be gradually increased to a minimum one-half of the total number.

3. Appointment of Directors

_ Directors shall be appointed through a transparent procedure that reflects broadly the diverse opinions of shareholders.

3.1 It is advised that a committee be established and managed for fair nomination of directors. The committee shall be organized such that the fairness and independence of the nomination process are ensured.

Directors appointed by the controlling shareholders or management is much influenced by them in performing their duties, thereby raising concerns their obligation of fairly executing duties as the managing agent of all the shareholders may be impaired. To maintain independence of directors, therefore, there shall be a procedure for appointing directors that broadly reflects the diverse opinions of shareholders.

For this purpose, there is a need to thoroughly examine the adoption of a committee system that allows recommendations of director nominees to be fairly made. For one, consideration needs to be given to the director nomination committee---formed at least one-half with outsider directors---that recommends the nominees for outside directors, and also a plan to gradually make recommendations for standing directors. Not only that, there needs to be a review of the method of establishing a shareholder committee---composed of shareholders based on their shareholding rank---who will represent the interests of shareholders overall.

3.2 The opinions of shareholders other than the controlling shareholder shall also be reflected when appointing directors. For this purpose, it is recommended that a cumulative voting system be adopted, and that it be disclosed regardless of its adoption.

In the process of nominating and appointing directors, the opinions of general shareholders shall also be reflected. If such a process is not improved, it would be difficult to expect directors---not just standing but also outside directors---to retain actual independence regardless of how much the requirements and qualification for outside directors are strengthened.

It would, therefore, be best to adopt the cumulative voting system, not just to ensure the independence of directors or to reflect the shareholders' diverse opinions when appointing directors, but also to consider the significant influence controlling shareholders yield on the management. To encourage adoption of this system, disclosure of whether such has been adopted by the corporation shall be made mandatory.

3.3 The Board shall make actual contribution to the corporate management by appointing competent professional directors, and shall respect the appointed directors' term of office.

For the Board to perform its functions dutifully and to make actual contribution to the corporate management, directors shall be competent and professional. Such directors refer to those possessing the following qualities: a vision for and a strategic perception of the corporate management; a level-headed and sound managerial judgment; an ability for managing and supervising the organization; a knowledge of law and finance; and some experience suitable for the corporation concerned.

On the other hand, the term of office for the director---appointed through due process at a general shareholder meeting---shall be respected so that his functions as managing agent for all shareholders may be performed dutifully. The exceptions are the following: the director is found liable for any illegal act; gross violation is made of the statutes or the Article of Incorporation; or the director is deemed quite inept for office.

3.4 The corporation shall, by disclosing the nominated directors prior to the general shareholder meeting, ensure that the shareholders exercise their voting rights with information on the nominees.

If the nominated directors, following the Board's decision, are not disclosed prior to the general shareholder meeting, shareholders will not have sufficient prior information on the nominees, rendering the meeting a mere formality. Therefore, any such information (e.g., personal profile) shall be disclosed beforehand, as it may aid the exercise of shareholders' voting rights and contribute to selecting competent directors.

For corporate information, it shall be made available using timely disclosure media to allow easy access by shareholders. There is a need to ease the corporation's burden of having to determine the nominees when the call to convene the general shareholder meeting is made.

The information on the nominees shall be disclosed at least three business days before the general shareholder meeting is convened, affording shareholders a minimum amount of time to evaluate it. When minority shareholders are looking to nominate directors, such intention shall be announced at the time the general shareholder meeting is notified; then the nominees shall be recommended and disclosed before the general shareholder meeting.

4. Outside Directors

_ Outside directors shall be able to independently participate in important corporate management decision-making, and to supervise and support the management as Board members.

4.1 Outside directors shall hold no interests that may hinder their independence from the corporation, management or controlling shareholder. The outside director shall submit a letter of confirmation, which the corporation shall disclose, stating that he holds no interests affiliated with the corporation, management or controlling shareholder at the time of his consent to the appointment.

The outside director system was adopted to strengthen the supervisory and supporting functions on the management. Therefore, outside directors shall be independent from the management or controlling shareholders, and shall hold no interests that might impair performing duties impartially from the corporation, management or controlling shareholder.

To ensure independence of outside directors, disclosures concerning any interest of the outside director at the appointment stage shall be strengthened. For this purpose, the outside director, at the time consent is given to appointment, shall submit a letter of confirmation, which the corporation shall disclose, stating that he holds no interests that might impair performing duties impartially from the corporation, management, and the controlling shareholder.

Though no concern exists of the impartial performance of the outside director's duties being impaired, he shall state in a letter of confirmation if there exist other interests and disclose such information. Also, should there be any change in the information stated in the letter following inauguration into office, the outside director shall immediately submit a corrected letter of which the corporation shall disclose.

4.2 The corporation shall provide, at the appropriate time, outside directors with information necessary to perform duties to allow accurate assessment of the corporation's managerial situation. Particularly, when a Board meeting is to be convened, information shall be provided beforehand so that the director may sufficiently review the agenda. Also, the outside director may request information necessary for performing duties to be swiftly provided. For important confidential information of the corporation, however, it shall be provided only at the request of the majority of outside directors, to which the management, barring any justifiable reason, shall comply.

For the outside director to perform his role effectively, he must receive sufficient information concerning business plans or the corporation's managerial situation. Therefore, management, including its head, must provide to outside directors any necessary information, sufficiently and timely, so that they may accurately assess the corporation's managerial situation. Particularly, when a Board meeting is to be convened, the related information on the pending agenda shall be provided to the outside directors to allow prior review.

An outside director shall be given easy access to information necessary for reviewing opinions on the management's objectives or the corporation's strategic decisions. For this purpose, the outside director shall be able to request information from anyone in the corporation. But to prevent leakage and abuse of confidential information, such shall be provided at the request of the majority of outside directors, of which the management or its head shall comply, barring any justifiable reason. Also, the corporation shall designate a division to oversee such matters within the corporation to facilitate any request for information by outside directors.

4.3 Outside directors shall allot sufficient time towards performing their duties, and shall review all related information before attending a Board meeting. Outside directors shall listen to the opinions of shareholders and shall make every effort to acquire information from various sources within and outside the corporation.

Outside directors shall, in performing their duties, collect and review sufficient information on the agenda up for decision-making and shall make every effort to make the best decision in the interests of the corporation. For this, the outside director shall allot sufficient time towards performing his duties, attending all Board meetings, and reviewing the material provided carefully. If the material proves insufficient, the outside director shall collect the necessary material himself and review them, e.g., reading the account books or related documents.

Also, outside directors shall endeavor to gather diverse opinions concerning the corporate management, and shall make every effort to obtain necessary information from diverse sources within and outside the corporation, including shareholders, to minimize the risk of management failure.

4.4 The outside director may receive support from executives, employees or outside professionals through due process when necessary, for which the corporation shall cover any reasonable expense.

The outside director shall, if necessary, be able to seek through due process the support or advice of executives, employees or outside professionals like external auditors, legal advisors and others. Any such expense incurred within reasonable limits shall be borne by the corporation.

4.5 To raise the outside director's management supervision and supporting functions, a regular meeting participated by outside directors only is recommended. Outside directors and the management shall put every effort to make opportunities for regular discussions on managerial issues.

The outside director system, adopted to raise transparency in corporate management, shall be approached more realistically and concretely if it is to take root and achieve its intended objective.

For this, a system of cooperation must first be established among outside directors. Meetings for outside directors-only shall be held regularly; a representative shall be appointed among the outside directors to supervise such a meeting and to handle important issues delegated to them.

Outside directors and the management shall make every effort to raise opportunities for regular discussions on matters concerning management. Through regular contact with the management, outside directors will be better able to manage the Board by clearly grasping the managerial situation; the management, on the other hand, will be able to gain the understanding and cooperation of outside directors concerning corporate management.

5. Steering of the Board

_ The Board shall be operated efficiently and rationally to allow the best course for management to be decided in the interests of the corporation and shareholders.

5.1 The Board meetings shall, in principle, be held regularly, at least once every quarter.

To convene a Board meeting, prior notification of its date and time shall be made to each director. The meeting, however, can be held at any time without effecting such a procedure, given the unanimous consent of the directors and auditors. Their unanimous consent is not required each time a meeting is held: The date and time of the Board meetings can be stated in the *Board Operating Regulations*, or can be decided with the consent of the full Board, thereby allowing meetings to be held without notification.

If the majority of directors are outside directors having other principal occupation, then the Board meeting could be run more efficiently if the management provided reports on important matters to the outside directors. The directors decide beforehand the venue for the meeting where they would be able to present their opinions.

There are significant differences in the issues and the actual role that the Board meeting plays in each corporation; therefore, it is difficult to decide on a uniform standard for the frequency of such meetings. But since the Board itself must vote on important matters concerning corporate management, Board meetings shall be held regularly, a minimum once every quarter, and special meetings held whenever necessary.

5.2 To efficiently operate Board meetings, the Board Operating Regulation shall be drafted that specifically states the Board's rights and responsibilities, along with the steering procedures.

Because the Board is composed of various standing and outside directors, a clearly defined standard for operating the Board meetings shall be required, without which disputes could arise in the actual steering process. To prepare for efficient running of board meetings, each corporation shall draft a *Board Operating Regulation* that comprehensively regulates matters related to the steering of Board meetings. The Regulations shall state the rights and authority, composition and operational procedures for Board meetings, all of which shall be observed.

5.3 The Board shall draft minutes or audio record proceedings of the meeting each time. The minutes shall state important discussion topics and resolutions as detailed and clearly as possible. The minutes and audio recordings of the Board meeting shall be maintained and stored.

To put reasonable pressure for accountability on the Board, it is important that detailed and exact records of the Board's discussions and resolutions, along with individual proposals and arguments, be kept.

Therefore, the corporation shall draft detailed minutes of the proceedings or shall make audio recordings of the entire meeting. The minutes or audio recordings shall be made for every Board meeting, along with important discussions and resolutions made by each speaker recorded clearly and in detail. Also, these records shall be maintained and stored, serving later as important pieces of evidence when problems concerning directors' accountability arise.

6. Committees of the Board

_ To have the Board run efficiently, committees composed of some of the directors may be established within the Board.

6.1 The Board may, if necessary, establish internal committees that perform specific functions and roles, such as the Audit, Operation and Remuneration Committees.

It is unreasonable for the full Board to convene on all occasions for handling corporate matters. Particularly with the sharp increase in the number of outside directors, it has become more difficult to convene a Board meeting frequently. Also, considering the size of the Board or the short length of meetings, it is not easy to achieve sufficient discussion or to arrive at a satisfactory resolution during meetings.

Therefore, an internal committee for each related field shall be established, and directors having such expertise or those interested shall be placed on the committee; the committee shall then focus on studying the important issues that occur periodically or that need closer review. Through operating these types of internal committees, the Board shall be able to raise professionalism and efficiency in their performance of duties.

6.2 The committee's resolution on a matter mandated by the Board shall hold the same effect as the Board's resolution, and the committee shall report such resolution to the Board.

For the Board with internal committees, the Board usually only performs duties which demand its direct attention under the law; other matters are delegated to the internal committees. When the Board mandates matters within its jurisdiction to the internal committee, the committee's resolutions shall hold the same effect as the Board's resolutions, allowing their actual functions to be performed. Also, the committee's resolutions shall be reported to the Board so that all its members are aware of the committee's activities.

7. Duties of Directors

_ Directors shall perform their duties fairly, with prudence and faithfulness, in the best interests of the corporation and its shareholders.

7.1 Directors shall, in performing their duties, do their utmost to observe the duties of prudence and faithfulness expected of a proper manager. Directors, as heads of corporate management, shall at all times seek results that would be in the best interests of the corporation and its shareholders.

Directors, according to the main purpose of entrustment as stewards, shall perform their duties with prudence of a proper manager. Directors shall review various materials with care and shall

attend all Board meetings, and if needed, receive the advice of specialists before attending.

A director may pose necessary questions and present opinions to the management on corporate operations. Also, if required, he may request advice from external auditors and outside specialists. In performing the duties, the director shall always be careful to ensure that no laws are violated by the corporation or himself.

7.2 Directors shall faithfully perform their duty of loyalty toward the corporation and shareholders. Directors shall not exercise their authority for their own benefit or that of a third party, and shall place the interests of the corporation and shareholders before themselves.

The duty of loyalty particularly applies when a conflict of interest arises between the corporation and the director, or when a certain opportunity may be used by both of them. When the director---as a party of the corporation, directly or indirectly---has any economic or personal gain in a contract or other transaction, or when he plans to engage in a transaction which is in competition with the corporation, then such director is considered as having an interest.

In such cases, the director shall act with the interests of the corporation before himself. When a conflict arises for the director having interests in a transaction or contract, he shall clearly disclose such interests and related important information to the Board, and also shall receive the approval of directors having no such interests.

7.3 Directors, in accordance to performing their duties, shall not divulge or use, for their own or third parties' benefit, any corporate secret obtained.

A director must keep secret any confidential matter of the corporation that he has acquired in the process of performing his duties. He shall not openly discuss the confidential matters, and he shall ensure that a third party does not reveal such information. Also, the director shall not use corporate secrets for his own gain or that of a third party. The use of corporate secrets by a director, even it bears no financial harm to the corporation, may erode confidence in the corporation or may incur losses on the part of shareholders and creditors; therefore, it shall be prohibited.

8. Responsibilities of Directors

_ When a director has violated the law or the articles of incorporation, or has neglected his duties, he may be liable for damages to the corporation or a third party. But managerial decisions by the director that are based on due process and also faithful and rational decision-making, shall be respected.

8.1 When a director has violated the law or the articles of incorporation, or has neglected his duties, he may be liable for damages to the corporation. If there was malicious intent or gross negligence on the part of the director, he may also be liable for damages to a third party.

A director shall observe the law and the articles of incorporation in performing his duties, and

shall not be negligent in his duties. If a director does not perform his duties properly, he may not be reappointed or may even be dismissed. These measures alone, however, do not ensure effectively the proper performance of duties by the director, and also do not make up for losses already incurred to the corporation and third party. An effective means of securing proper performance of duties by the director is to hold him materially accountable, that is, in proportional terms.

8.2 If the director, in the process of making a managerial decision, has collected and sufficiently reviewed with care a significant amount of reliable material and information, and has then performed his duties---according to his faithful and reasonable judgment---using means deemed to be in the best interests of the corporation, then such decision shall be respected.

Managing a corporation is very complicated, requiring technical knowledge. Therefore, it is almost impossible, and inappropriate, to hold one accountable for damages by determining any existence of negligence based on examination of *ex post* results. Directors may perform their duty with conviction only if actions made within their capacity, based on reasonable judgment, are respected.

The United States recognizes the business judgment rule in relation to limiting responsibilities. There are two major reasons why such principle was applied to directors. First, if the director has committed an act, although considered wrong, with all due faithfulness and prudence, he shall be exempted from any responsibility, thereby enabling him to maintain his adventurous yet entrepreneurial spirit. Second, it is not appropriate for the court of law, as a non-professional in the field of management, to directly intervene in business judgments of directors.

Generally, the business judgment rule is only applied with respect to the following cases: The director shall make active business judgments concerning operations of the corporation, and he shall not have any interests on matters needing business judgment. He shall, in the process of making a business judgment, make decisions only after collecting and reviewing---sufficiently and carefully---a significant amount of reasonably reliable data and information. Also, the director shall rationally believe that such business judgment is of benefit to the corporation.

Considering that an environment would be created whereby directors could act with conviction and that competent managers be protected, the business judgment rule shall be adopted. It is difficult to predict results of corporation's managerial activities due to changing circumstances. Therefore, the court of law shall uphold caution when ruling on the question of negligence in the directors' business judgment.

8.3 The corporation, to ensure effectiveness of holding directors accountable and to attract competent persons as directors, may purchase, at its own expense, coverage for the directors with liability insurance.

As the size of corporations grows, the amount involved in liability claims on directors is expanding. Therefore, the effectiveness of filing a suit for accountability would decrease if the director lacks sufficient funds. To ensure such effectiveness, liability insurance shall be purchased with a portion of the directors' remuneration so that compensation can be adequately made for damages to the corporation or third party. Also, to actively recruit those competent but shy due to possibility of lawsuits on outside directors, it is recommended that corporations

seriously consider purchasing liability insurance for directors.

However, controversy could arise concerning the question of legitimacy in purchasing liability insurance at the corporation's expense to pay for director's liabilities towards the corporation or third party. Therefore, it would be best if the corporation pay for insurance premiums for liability insurance to supplement for any losses by directors to the extent that no irresponsible business judgment is encouraged.

9. Evaluation and Compensation

_ To promote active performance of duties by the management, outside directors and the Board, their activities shall undergo fair evaluation; based on such results, the matters of remuneration and reappointment shall be decided.

9.1 Business activities of the management shall be evaluated fairly, and the evaluation results shall be reflected appropriately in the remuneration. Remuneration for the management shall be decided by the Board, that is, within the limit approved by the general shareholder meeting. If a committee centered on outside directors is established within the Board, then that committee may make the decision.

The ultimate goal of evaluating the management's activities lies in enhancing the corporation's business results by increasing their rate of contribution to the corporation. Therefore, the management's activities shall be evaluated under objective standards, including business results, achievement of business strategy goals, and others. The evaluation results shall be used as the basis for determining remuneration and reappointment for management.

Remuneration for the management shall be decided by the Board, that is, within the limit approved by the general shareholder meeting. If an internal committee exists within the Board, it would be best for that committee to propose the remuneration for the management and to gain the Board's approval. Such remuneration shall be rational---proportional to the position---as it is compensation for performance of duties. Also, the amount decided shall be befitting of the corporation's financial state.

Calculation criteria for stock options shall always be disclosed in detail prior to any decision regarding it; such criteria shall in general be justified to accurately reflect results achieved through the management's efforts. Also, it would be best to place a ceiling on the criteria, so that the shareholder's interests are not unduly infringed with inordinate endowment of stock options, despite the criteria being reasonable.

9.2 The activities of an outside director should be evaluated fairly, with the remuneration being commensurate to the evaluation results. Activities and evaluation results of outside directors shall be disclosed.

Evaluations on outside directors shall be based on their contributions, and such results shall be used as grounds for deciding the remuneration and reappointment of outside directors. Remuneration for outside directors shall be decided at an amount deemed appropriate; this is considering the responsibility and risk involved with their duties, and also their time allotted to performing such duties. The activities and evaluation results of outside directors, through

disclosure, shall aid in the shareholders' decision-making and shall be reflected in the human resources market for business managers.

9.3 Activities of the Board shall be evaluated fairly, the results of which shall be disclosed.

Regarding the activities of the Board, an internal committee may evaluate the Board and its results tendered to the Board for examination. Other possibilities are the evaluation of Board's activities by the general shareholder meeting or by the business manager human resources market; recently, the latter has been regarded as making more effective evaluations.

Therefore, activities and the evaluation results of the Board shall, through disclosure, assist in the decision-making by shareholders and shall be reflected in the business manager human resources market. Such disclosures presented in the annual report are also advisable.

III. Audit Systems

- Audits shall be performed by those independent from stakeholders in the corporation, such as the management or controlling shareholder, and by those who specialize in auditing.
- Auditors shall audit with sufficient information provided and shall invest much time and effort.
- Auditors shall not reveal, unless required by law, any confidential corporate information learned while auditing.

1. Internal Audit Systems

_ Internal auditing bodies, such as audit committees and auditors, shall perform auditing operations faithfully by maintaining independence from the management and controlling shareholders.

1.1 The Board of large public corporations, government-invested institutions and financial institutions shall establish an audit committee as an internal committee. A corporation establishing an audit committee shall not employ auditors.

An audit committee is expected, through checks and balances, to bring positive results in supervising and supporting the management of large corporations whose business activities have become complex, and the financial institutions whose stakeholders are diverse. This is so that they may ultimately maximize the corporation's value. Therefore, large public corporations, government-invested institutions, financial institutions and other corporations whose goals reflect strong public interest shall establish audit committees within the Board.

A corporation that establishes an audit committee shall retain auditors. The coexistence of auditors and audit committees would place more burden on the corporation; inefficiency may be bred due to conflicts with each other.

1.2 An audit committee shall be composed of the following: a minimum of three Board members; a minimum two-thirds, including the committee chair, shall be outside directors; and one member shall be a person possessing professional knowledge of auditing. A corporation without an audit committee shall employ at least one standing auditor.

The audit committee, as a conference body, shall be composed of a minimum of three members to function smoothly. For the audit committee to maintain objectivity and independence, a minimum two-thirds that includes the committee chair shall be outside directors.

The audit committee, due to its position as an internal committee of the Board, may retain less independence than auditors. For the audit committee to be able to perform appropriate auditing, therefore, the rights and authority of the audit committee shall be rendered equal to those of auditors, or a legal system shall be established so that the audit committee cannot be dismissed arbitrarily by controlling shareholders and others. For example, one means of raising the status

of audit committee members is to have them selected by the general shareholder meeting when appointing directors.

Auditing requires expertise. An auditing person does not require a professional license, but he shall have understanding of accounting standards, financial reporting, and the internal control systems; he shall possess such experience and knowledge so that judgments on such matters may be made. Therefore, at least one member of the audit committee shall be a person with professional knowledge of auditing.

1.3 Audit committees and auditors shall at least perform the following functions:

- **Audit the appropriateness of the manager's execution of operations;**
- **Review the soundness and reasonableness of financial activities and the accuracy of the corporation's financial reports;**
- **Review the adequacy of major accounting standards and changes in accounting estimates;**
- **Evaluate internal control systems;**
- **Approve the appointment or dismissal of persons heading internal auditing divisions (for only audit committees);**
- **Evaluate the auditing activities of external auditors;**
- **Recommend nominees for external auditors (for only audit committees);**
- **Check measures on those matters corrected as a result of auditing.**

Accounting changes hinder the continuity of corporate accounting and give rise to confusion to readers of the accounting information; it is therefore discouraged. The audit committee or auditors, as a result, shall examine the appropriateness of the accounting changes, even if permitted under corporate accounting standards.

Designing and running the internal control system is the responsibility of the management, but evaluating its appropriateness and seeking points for improvement is the duty of the audit committee or auditors. The audit committee or auditors shall check the existence and efficacy of a management system for protecting corporate assets, and also shall evaluate whether appropriate checks are being made between internal system units. The audit committee and auditors shall, on the basis of these evaluations, seek means of maintaining the appropriateness of internal control systems.

As the audit committee cannot supervise all operations on its own, it shall receive much support from employees performing internal auditing operations. Therefore, the independence of these employees is a prerequisite to assuring efficacy of auditing operations. If an audit committee exists, it shall be mandated, at the very least, with the authority to approve or dismiss persons heading internal auditing divisions, thereby ensuring their independence. If an auditor is employed, it would be difficult to give such authority, but the Board or the representative director shall be customarily made to voluntarily ask for the auditor's opinion.

The audit committee or auditor nomination committee recommends a nominee for external auditor to the general shareholder meeting. It would be quite burdensome to the corporation to form an auditor nomination committee if the corporation already has an audit committee. Considering that preexisting auditor nomination committees included major interested parties, however, the audit committees of corporations with a high debt ratio shall consider creditors' opinions when recommending nominees for external auditors.

The audit committee shall decide regularly the question of re-appointing external auditors by evaluating whether they have invested sufficient time and effort in performing auditing operations, and also by evaluating the independence of external auditors. Also, when the external auditors give advice on management besides that of performing accounting audit, measures shall be taken so that the independence of external auditors is not affected.

The audit committee and auditor, in the case of material conflict of opinion between the management and external auditors, shall propose a solution and check thereafter its performance. Furthermore, the audit committee or auditor shall check whether major corrective measures indicated by external auditors have been reflected in the execution of operations.

1.4 Matters concerning the authority, responsibility and operation of the audit committee or auditors shall be stated in the corporation's bylaws.

If an audit committee is established, a standard basis for operations of the audit committee shall be provided, by stating in the form of bylaws such as the *Board Operating Regulations* and *Audit Committee Operating Regulations*, the qualifications, rights, duties, responsibilities and operations of the audit committee members. Also, companies with only auditors shall also provide bylaws concerning specific standards and procedures for audits.

1.5 The audit committee shall hold meetings at least once each quarter, and if need arises, may allow the attendance of the management, financial officers, chair of an internal audit division or external auditors.

To ensure the effectiveness of quarterly reporting, the audit committee shall review the quarterly reporting process. Therefore, the audit committee shall hold a meeting at least once every quarter.

The chair of the audit committee may demand the attendance of the management, financial officers, head of an internal auditing division or external auditors at a meeting of the audit committee. He may also allow the attendance of outsiders depending on the slated issue. If the agenda of the audit committee meeting includes the performance evaluation of the management, then the management shall not be allowed to attend. Also, members of the audit committee shall try to collect information and exchange opinions through individual contact---separate from official meetings---with the management, employees of internal auditing divisions, and external auditors.

1.6 The audit committee shall draft minutes of proceedings each time a meeting is convened, and the minutes shall state in detail and clearly the major discussion topics and resolutions. The audit committee and auditors shall compose audit records that give detailed results of audits.

The minutes of meetings and audit records shall be drafted clearly and in detail, and shareholders, under the law, shall be allowed to read them.

1.7 Members of the audit committee and auditors shall be allowed full access to

information necessary for audits, and if need arises, may receive the advice of external experts.

Full access to necessary information is a prerequisite for audit committees and auditors to perform their duties faithfully. For this, it is necessary that bylaws press responsibility on persons who, without just cause, do not meet the request for information by audit committees or auditors.

Other than cooperation from officers and employees or external auditors, audit committees and auditors may need the advice of external experts, such as accountants and lawyers, to perform their duties. Therefore, related internal regulations, such as *Board Operating Regulations* and *Audit Committee Operating Regulations*, shall provide the basis for enabling the audit committee or auditor to receive advice from external experts. In particular, when the audit committee utilizes external experts, it shall be made mandatory for the chair of the audit committee to report to the Board a statement on the background, contents, expenses attached to the advice, follow-up measures, and its results.

1.8 The audit committee shall report to the general shareholders meeting matters concerning the personal history of its members and its major activities; the representative director shall disclose the information in the annual report. The corporation without an audit committee shall report major activities of auditors to the general shareholders meeting and shall disclose such activities in the annual report.

Personal profile of audit committee members, members' existing important transactions with the corporation, and other interests in the corporation that may influence their independence shall all be disclosed in the annual report. This is regardless of whether they have performed their duties of the audit committees and other major activities, as indicated by related statutes and the *Audit Committee Operating Regulations*.

2. External Auditors

External auditors shall perform fair audits independently from the corporation concerned, its management and controlling shareholders, so that shareholders and other users may maintain confidence in the corporation's accounting information.

2.1 External auditors shall maintain independence in reality and in appearance from the corporation subject to audit, its management, and controlling shareholders.

Statutes related to external auditors state regulations on the independence of external auditors. But it is, above all, most important that external auditors themselves, backed by work ethics, do not enter into an accounting audit contract whereby it is judged that they hold interests, in reality or in appearance, with the management or controlling shareholders of the corporation.

External auditors are considered not to be independent, in principle, if they perform bookkeeping for the corporation, or give management consulting or tax advice. However, exceptions are made for management consulting or tax advice if the accounting corporation concerned clearly separates its accounting audit divisions from the concerned divisions. Not

considered independent are cases where success fee agreements have been made in relation to audits of financial statements for a specific purpose.

2.2 External auditors shall attend the general shareholder meeting and answer any shareholders' question on audit reports.

To vitalize the business supervisory role of shareholders, external auditors shall attend the general shareholder meeting and answer any question posed by shareholders related to the submitted audit reports.

2.3 External auditors are liable to pay for damages incurred from negligent accounting audit to the corporation concerned and to other information users. External auditors shall check whether any fact conflicts with the audit results in the information disclosed regularly with the audited financial statements.

If external auditors have been negligent in their duties, incurred losses on the corporation, omitted important matters from the audit reports, or incurred losses to information users due to false records, then they are liable for damages toward the audited corporation and any third party. Therefore, external auditors shall be aware of this liability and heed special care when auditing.

Also, external auditors shall demand correction of corporate information included in regularly disclosed business reports with audit reports and audited financial statements. This may include information that conflicts with audit results or that may cause misunderstanding on audited financial statements.

2.4 External auditors shall make every effort to check any existence of wrongdoing or law violation by the corporation during audits.

External auditors are not obligated to check any wrongdoing or law violation of the corporation being audited. However, checking for any such misdeed by the corporation while performing accounting audits may increase confidence of those readers in the audit results. It especially holds significant meaning when accounting auditors, during the course of auditing consolidated and combined financial statements, unmask any wrongdoing or law violation that occur among corporations, large corporate groups, and affiliated subordinate companies. External auditors may check such facts in auditing and officially notify related institutions of any wrongdoing or suspicion of law violation.

2.5 External auditors shall consider the possibility of continuance of the audited corporation as specified in statutes related to external auditors.

The fact that external auditors express opinion on the possibility of continuance for an audited corporation means that their responsibility becomes just as great. Therefore, adverse effects are possible: for example, external auditors may evade accounting audits on insolvent corporations or may give excessively conservative audit opinions to evade responsibility.

However, positive effects are expected to surpass those adverse. The opinions of external

auditors on the possible continuance of the audited corporation will help determine the actual state of the corporation and will enhance the quality of accounting audits. Remuneration for external auditors shall be adjusted accordingly to these extra responsibilities; and the external auditors shall be able to easily access information needed to assess the possibility of continuance of the corporation.

IV. Stakeholders

- **The rights and authority of interested parties according to the law and contract shall be protected.**
- **Participation of interested parties in corporate governance shall be determined autonomously, considering the level of interests of the parties and the rights protection systems.**
- **Corporations and interested parties shall cooperate for mutual benefit.**

1. Protection of Stakeholder Rights

_ Rights of stakeholders according to the law and contract shall be protected, and stakeholders shall hold appropriate means of redress for infringement of rights.

1.1 Corporations shall observe creditor protection procedures concerning matters, such as mergers, capital decrease and split mergers, which greatly affect the position of creditors. The corporations shall notify beforehand the creditors concerned for matters that may bring changes in the creditors' priority, or may have material influence on the possibility of collecting credit.

Creditors that have extended credit to the corporation or that are holders of corporate bonds bearing risk over collecting invested capital, therefore, shall be protected through appropriate procedure.

Mergers, capital decrease, and split mergers are matters that materially influence changes in the structural and/or financial status of the corporation and that influence the creditors' position also. Therefore, the corporation shall ensure that the creditors' rights are protected sufficiently and appropriately beforehand in the event of mergers, capital decrease or split mergers---matters which pose great influence on the creditors' position. Also, the corporation shall notify the creditors concerned beforehand when there is an issuance of preferred bonds which changes the current priority of creditors, or when it is interpreted generally that the possibility of collecting credit is worsened.

1.2 Corporations shall make every effort to maintain and improve labor conditions by faithfully observing labor-related statutes such as the Labor Standard Act.

At present, the rights of employees are stated in labor-related statutes, including the *Labor Standard Act*. According to such Act, the employer shall decide labor conditions from a perspective matching that of the employees who are, in fact, the direct contributors to creating corporate value. He shall also make every effort to observe the labor conditions decided and to stabilize employment; employees bear the same responsibility. Labor unions and *Labor Relations Adjustment Act* state the three labor rights, that is, the right of organization, the right

to collective bargaining, and the right to collective action.

The corporation shall make every effort to maintain and improve labor conditions, faithfully observing labor-related statutes such as the *Labor Standard Act*, *Labor Union Act*, and *Labor Relations Adjustment Act*.

1.3 Corporations shall not be negligent in their social responsibilities, such as consumer protection and environmental protection.

With the significant rise of corporation's influence on the economy and society, similarly increasing has been the recognition of general public's concern about corporation's social responsibilities. Also, consumers and regional societies have been increasing in importance as interested parties in the continuance of the corporation.

In particular, if the corporation neglects its social responsibilities, such as protecting consumer rights or the environment using its vantage, it will, unlike the past, lead to a very adverse effect on its long-term development as well as to a decline in its image. Therefore, each corporation shall enable its managers to faithfully perform its social responsibilities through an appropriate governance system.

1.4 When stakeholders hold the dual position of a shareholder, each of the rights pertaining to stakeholder and shareholder is protected and can be exercised.

If a certain person has the dual positions of shareholder and stakeholder, in other words, is a supplier as well as shareholder, or is an employee as well as shareholder, the rights pertaining to each position are protected independent of each other.

Rights as a shareholder must not be unduly restricted due to the person's position as a stakeholder, and a stakeholder must not pursue undue profit using his position as a shareholder.

1.5 If the corporation infringes upon the rights of stakeholders, the corporation shall take appropriate measures for redress, and the stakeholders shall retain means to efficient redress if their rights have been infringed.

The corporation holds diverse relations with stakeholders, those being employees, creditors, suppliers, consumers and community. Also, the roles played by the stakeholders are very important to the continuance of the corporation. Therefore, the corporation shall realize that mutual cooperation with stakeholders is, in the long term, to its own benefit, and shall respect and protect rights of stakeholders, as determined by statutes and contracts.

Also, when the corporation infringes upon the rights of stakeholders stated in statutes or contracts, it shall take appropriate and swift relief measures; the interested parties shall retain means through which they may receive compensation efficiently if their rights are violated.

2. Stakeholders' Participation in Management Monitoring

_ The form and level of monitoring on management by stakeholders shall be determined separately for each corporation, considering the characteristics of stakeholders and the

incentive for management monitoring. Stakeholders shall have access to relevant information to protect their rights.

2.1 The form and level of management monitoring by creditors shall be determined through discussion among the related parties, according to the corporation's distinctive qualities.

Creditors assume the corporation's risk depending on the possibility of collecting their credit, and therefore have a strong motive for monitoring the corporate management.

Due to the popularization of non-guaranteed corporate bonds and credit extensions, creditors and shareholders alike have been exposed to the corporation's risk. Therefore, a growing need arises for creditors to perform appropriate monitoring of corporate management. From this perspective, the creditor's role in monitoring management and participating in corporate governance is necessary but it would be inappropriate to decide uniformity for all, as diverse are the interests of creditors. Therefore, the form and level of creditors' participation in corporate governance shall be determined according to the corporation's distinctive qualities through a discussion or contract among the related parties.

2.2 The form and level of employee participation in corporate governance shall be determined so that the corporation may achieve sound development.

The current *Act on Worker Participation and Promotion of Cooperation* enforces the convening of labor-management consultative meetings, during which the employers are required to report and explain the business plans, matters concerning their implementation, quarterly production plans and performances, personnel plans, and the corporation's financial status.

Such a meeting system has been provided to enhance the corporation's productivity and to strengthen its competitiveness through active cooperation and participation of employees. On the other hand, this system has also been provided to enable employees to monitor management in a constructive way. By such, the employees' participatory role in management, under the law, shall be promoted; for this purpose, it would be best to accept favorably and execute such stated in the *Act on Worker Participation and Promotion of Cooperation*.

Regarding employee participation in management, utilizing profit sharing mechanisms shall be considered: such include the employee share ownership or incentive system, and the method of providing a certain ratio of bonuses and incentives as stocks. The employees, possessing corporate stocks, are participating in the corporation's capital, thereby helping strengthen employee-employer collaboration. Also, the employees may indirectly monitor the management, contributing to the improvement of labor conditions.

2.3 The corporation shall, under the limits indicated by law, provide stakeholders with relevant information necessary for protecting their rights; and the stakeholders shall have access to relevant information.

Creditors shall have access to information necessary to assess their risk and to manage their credit. For this purpose, the creditor shall access corporate information by specifying, in loan

agreements or corporate bond subscription entrustment agreements, matters of the following: the prior consent of creditors required by the corporation as borrower; the notification of creditors; matters concerning financial restrictions; and others. The corporation shall faithfully implement the agreement with creditors as stated in the contracts, and must inform the related creditors of matters that influence the existing creditors, such as preferential treatment contracts for specific creditors.

Employees shall also have access to corporate information to protect their rights. Currently, the *Act on Worker Participation and Promotion of Cooperation* states that the employer shall report and explain to the labor-management consultative meeting the business plans, quarterly production plans and performance, personnel plans and overall corporate financial situation.

On the other hand, there may be adverse side effects, such as the leakage of corporate secrets and the misuse of undisclosed information, if no restriction exists for the access of corporate information by stakeholders, like creditors and employees. Therefore, the corporation shall provide relevant information, under the limits indicated by law, to the interested parties. Also, stakeholders that have acquired corporate information shall not use such for unjust purposes.

V. Management Monitoring by the Market

- **Formation and function of related markets shall be protected so that corporate takeovers may be used as a means to raise efficiency of corporate management, thereby further increasing corporate value.**
- **Corporations shall actively disclose matters of material importance to the decision-making of shareholders, creditors and other interested parties.**
- **Corporations, to become equipped with a sound governance structure, shall actively disclose their governance so that interested parties such as shareholders may evaluate them.**

1. Market for Corporate Control

_ Takeover shall be achieved without infringing on the corporate value.

1.1 Acts that may lead to change in corporate control, such as takeovers, mergers, acquisitions, splits and transfers of business, shall occur through a transparent and fair procedure.

Corporate takeovers and other such acts greatly affect stakeholders, such as shareholders and creditors; therefore, such acts shall occur through a transparent and fair means based on proper disclosure.

1.2 Acts of defending corporate control shall not involve sacrificing the profit of corporations and shareholders to maintain corporate control for only some shareholders or management.

When using the corporate assets as a means of defense against takeover, the interests of the management and shareholders or interests within the management may conflict. The Board may fight against hostile takeovers through legal procedures; but even such cases may not use corporate assets to maintain their purposes while sacrificing the interests of the corporation and shareholders.

When acquiring treasury stocks to defend corporate control, the purpose for such shall be announced in detail so that all stakeholders may understand the underlying reason and may predict its consequences.

Another means of protecting corporate control is to issue to third parties new shares and potential shares, such as convertible bonds and bonds with warrants; such acts limit the rights of

the shareholder and thus shall occur through fair pricing and procedures.

1.3 Corporations shall, as determined by law, accept stock purchase requests from shareholders opposing material structural changes, such as mergers and business transfers, through fair prices that reflect the actual share value.

If a change in corporate control occurs through takeover, merger or others, a limit would be placed on the extent that minority shareholders could fulfill their intentions and protect their interests; therefore, the stock purchase request system under fair prices becomes very important.

It is most desirable that the stock purchase price be decided by an agreement between the corporation and opposing shareholders. For public companies, however, shareholders may sell their shares in the market if they oppose the takeover; thus, determining the stock purchase price through agreement is, in fact, difficult. For public corporations, therefore, the stock price determined in the stock market shall be reflected when calculating the buying price.

2. Disclosure

_ Corporations shall disclose material information in a timely and accurate manner.

2.1 Corporations shall disclose any information, not just limited to those required under law, that may materially influence the decision-making of shareholders and other stakeholders.

Active and appropriate disclosure, as the corporation's obligation to shareholders and other stakeholders, of corporate information will raise their confidence and will give equal opportunity to market participants, while preventing unfair practices using undisclosed information.

Therefore, the corporation shall disclose information, other than those determined by law, that may be of material influence in the stakeholders' decision-making through proper means; if the information is not confidential, investors shall access it in a fair, timely and cost-efficient manner.

2.2 The annual report shall include the following information:

- **Business goals and strategies;**
- **Financial condition and business performance;**
- **Status of shareholders and statistics on exercise of shareholder rights;**
- **Cross-shareholdings and cross-debt guarantees;**
- **Capital increase and capital expenditure for the fiscal year;**
- **Business climate and risk factors;**
- **Information on executives and employees;**
- **Remuneration system for directors, auditors and executives;**
- **Evaluation of external auditors, credit rating agencies and others;**
- **Disclosure rule violation and subsequent sanction.**

A public corporation, according to law, shall disclose---accurately and periodically---information on the corporation, such as general business condition, financial status, and business performance.

However, items in the annual report, such as summary financial statements and explanatory notes that overlap with audit reports and business reports, may be omitted; this would relax the burden of disclosure on the corporation.

2.3 In the annual report, a public corporation shall explain the differences between its corporate governance and this Code, and the reasons for such; any plans to make future changes shall also be explained.

The corporation designs the governance structure reflecting its own distinct circumstances; therefore, each corporation's governance structure may differ. However, the corporation shall explain to the parties of interest, including shareholders, the reasons why it is operated differently from this Code.

Major items concerning governance for disclosure are: 1) the adoption of cumulative voting system; 2) information on the composition of the Board, along with outside directors and their independence; 3) the composition, rights, and activities of the Board's internal committees; and 4) activities of directors and the Board.

2.4 Corporations shall prepare and disclose semi-annual reports, apart from annual reports. If one corporation is in fact under a control and subordinate relationship to another corporation, consolidated financial statements and combined financial statements, as determined by law, shall additionally be disclosed.

The range of items for inclusion in the consolidated financial statements, aside from share ownership criteria, shall be determined considering the existence of a control and subordinate relationship that may actually govern business operations, investment, and financial activities. For Korean corporations, those that constitute governing relationships are not only ruling and subordinating relationships between corporations, but also controlling shareholders and specially related persons; therefore, the actual entity of a corporate group as a whole cannot be determined simply by the share ownership between corporations. The representative corporation among the group, as a result, shall additionally disclose combined financial statements so that the corporate group as a whole may be understood.

2.5 Corporations shall make timely and accurately disclosures when matters of importance have been decided, as follows. If the decision has been made through a resolution of the Board, details on the attending directors and voting results shall also be disclosed.

- **Matters that may have material influence on the financial structure or business operation of the corporation;**
- **Matters concerning the issue of shares;**
- **Matters entailing material changes in the assets, operations, and business climate of the corporation;**
- **Matters entailing major changes in debt and credit relations;**
- **Matters concerning important investments and financing;**

- **Matters entailing material changes in the profit and loss structure;**
- **Matters that bring changes to the corporate control and management structure;**
- **Matters concerning dividend.**

The corporation shall, in detail, disclose immediately after the occurrence of matters that are deemed important by those using the disclosure information, even if they are not mandatory disclosure matters stated in related statutes, such as the *Securities and Exchange Act*.

The disclosure of corporate information is not limited to facts that have already occurred, but also include forecasts on future business performance and financial condition. The corporation, in unveiling such forecasts, shall not disclose only information advantageous for its own benefit and shall not evade or delay disclosing matters deemed disadvantageous. However, it may be delayed for a certain period of time if the matter requires sophisticated security for the public's benefit, such as national secrets, or if deemed a confidential business matter, such as R&D results. Exceptions are made in cases where information was leaked because the corporation failed to maintain confidentiality, for which such information shall be immediately disclosed to the public.

2.6 Corporations shall prepare items for disclosure that may easily be understood, and shall assist so that access to them is possible at minimal cost.

Due to diversification, high-technology orientation, and specialization of industries, comprehension would be difficult if corporate information is provided in technical terms. Therefore, such information shall be prepared in the simplest terms possible; and when using technical terms, explanations shall be attached so that the general public may easily understand the contents. Also, ambiguous terms shall be avoided. The means for disseminating information shall be what the corporation finds convenient to use and what is determined the fast mode of transmission.

2.7 Corporations holding a significant portion of shares to enable foreigners to participate in corporate governance are advised to make disclosures in both English and Korean for audit reports and material timely disclosure.

Due to the liberalization of capital movement, there has been an increase in the number of foreign shareholders and in their shareholding ratio of Korean corporations. Therefore, any disclosure concerning the corporation shall consider these foreign shareholders. Furthermore, the need for disclosures in English has been increasing more and more for corporations to better do capital raising.

It is desirable that public corporations disclose information using Korean and English side by side. However, considering the burden on the corporation, it is recommended that corporations having many foreign shareholders make disclosures in English. For example, a corporation with a minimum of twenty percent of the total shares issued owned by foreigners shall disclose its information in English on the basis of providing shareholder protection.

2.8 The corporation shall designate a person to oversee disclosure matters, and an internal information control system shall be established so that important corporate information may be quickly transmitted to such person.

Selecting information that needs to be disclosed and also announcing such information effectively are an important part of operations that requires specialization. Therefore, each corporation shall assign a person with specialized knowledge to oversee disclosure.

Also, to disclose corporate information in a timely and accurate manner, persons overseeing disclosure shall be given the right to quick access to major corporate decisions; a system shall be established which will immediately notify them should any new information arise.

2.9 Corporations shall disclose detailed information on the share ownership status of controlling shareholders and on persons of special relation to them.

The actual controlling shareholder of the corporation is one at the core of corporate governance. Therefore, the status of shareholdings and changes, position in the corporation, and transactions with the corporation that concern the controlling shareholder, shall all be disclosed in detail.

Recommendations

- 1. The government shall amend laws so that this Code may be actively used as a standard for corporate governance of public companies. And related institutions shall revise their own systems to treat favorably those companies with exemplary corporate governance system.**
- 2. To establish sound governance structure within the corporation, financial institutions and credit rating agencies shall include the quality and efficiency of governance structure in evaluations when rating the credit of corporations.**
- 3. Institutional systems, such as establishing intermediary institutions shall be provided, so that if the rights of shareholders and creditors are infringed, they may quickly receive sufficient compensation or remedy through such simple procedure at low cost without filing claims.**

If a shareholder or creditor deems that his rights have been infringed, it can presently only be remedied by claiming damages or filing a claim against the corporation or its directors. However, these means are not appropriate remedies because of the high expenses and complicated procedures. Therefore, systems are necessary for settling disputes at minimal expense and through quick procedures without filing claims.

- 4. Facilitate the exercise of rights for minority shareholders, and take measures against abuse of rights by minority shareholders.**

With the development of the securities market in Korea, stock diversification has been accelerating, and the number of minority shareholders and their importance have been increasing as well. Therefore, it is necessary that the requirement for exercising minority shareholder rights be relaxed to protect their rights. At the same time, considering the economic consequences from exercising minority shareholder rights, measures shall be taken to prevent excessive claims from being filed.

- 5. Institutional investors that manage trust assets shall actively exercise their shareholder rights and monitor corporate management.**

- 5.1 Institutional investors, by exercising shareholder rights, shall enact and officially announce internal principles for exercising such rights to protect trust assets; and the rights shall be exercised actively and prudently according to the principle of good faith.**

For the proper exercising of shareholder rights, first, institutional investors set up an appropriate internal principles on exercising shareholder rights. Certain action standards, such as approval or disapproval of a certain agenda at the general shareholders meeting, may be a compass for decision-making and for determining the direction to take action of the management of investing corporations.

Second, the principle of good faith shall be individually or jointly enacted for the protection of trust assets and then announced; shareholder rights shall be actively and carefully exercised. This is because institutional investors, such as banks, investment trust companies and insurance companies, each have different owners and governance structures and have diverse transactional relations with customers and corporations; also, the incentives between shareholders differ

according to investment purpose.

If institutional investors, on their own, do not provide internal principles and principle of good faith, councils composed of institutional investors from each industry or related institutions shall draft the guideline and lead institutional investors to adopt these in their internal regulations. Institutional investors shall also be led to disclose policies on the problem of corporate governance, such as the exercise of voting rights, so that investors (optional for institutional investors) may refer to them. Furthermore, adopting such a guideline as related regulations for supervisory institutions shall be seriously considered.

5.2 Institutional investors in transactions with the corporation, and all other acts, shall not engage in insider trading which abuse their position or use important undisclosed information.

Institutional investors, using their vantage compared to other investors, may acquire with relative ease information on the investment-targeted corporation, and may request the business information from managers to be smoothly provided. The corporation, from its perspective, also has an incentive to individually provide institutional investors with corporate information as a means of ensuring friendly shareholders for business stability. Therefore, stronger restraining measures are needed against institutional investors than for ordinary shareholders to prevent them from acquiring and using corporate information through their vantage positions.

5.3 Restrictions on the exercising shareholder rights of institutional investors to the corporation with a special relationship should be clearly stated by law.

The corporation possessing an institutional investor through a subsidiary, the corporate group and the individual using another corporation's equity held by the institutional investor---acquiring such corporation's managerial right or exercising the shareholder rights for the stakeholder needs to be appropriately regulated based on protecting other shareholders and beneficiaries. For this, the following are desirable: the exercise of shareholder rights be limited for identical subsidiaries of institutional investors within a corporate group; the total investment ceiling be determined for stock investment; and the legal guideline be strengthened. Also needed are both the external control system and institutional investor's internal control system for monitoring such to be first set in place.

5.4 Institutional investors shall be equipped with internal control systems to ensure fair exercising of shareholder rights.

6. Outside directors have the same rights and responsibilities as standing directors. However, considering the limitations on the actual performance of duties due to time constraint and the limitations in acquiring information as a non-standing director, outside directors shall be given responsibilities proportionately within the range of operations that may actually be performed.

7. Securities-related disclosure institutions shall maintain disclosure systems appropriate for developments in information/communication technology so that corporations and information users may use corporate information in a fair, easy and low cost manner.

8. The management shall be supervised properly so that unilateral decisions of the management do not infringe the interests of corporate bondholders. In relation to this, it is advised that systems and customs be in place so that the managing underwriter and

trustee corporation may do their jobs properly.

The Korean corporate bond market has recently been reorganizing into a market centered on non-guaranteed bonds from guaranteed bonds. However, the institutions and customs of the corporate bond market are not yet properly reflecting such changes in circumstances, increasing the investment risk of creditors. For example, creditors will have trouble with supervision and control if the corporation: changes the use of funds to those that differ from its original purpose of bond issuance; issues additional bonds, thereby depreciating the ability to repay the principal; or engages in other business activities which entail a much greater disadvantageous situation than when the bonds were issued.

Therefore, the corporation shall provide creditors with transparent information on materials of corporate value and business activities from the time when liability incurred to that of repayment. In this way, creditors shall be allowed to understand accurately the corporation's value and investment risks. For this purpose, the issuing corporation must actively cooperate so that the interim *pro forma* managing underwriter and the trustee corporation may actually perform their roles.

The managing underwriter and commissioned corporation shall, at the time of bond issuance, investigate the evaluation material on the corporation and bonds, and the contract fulfillment situation of the issuing corporation and major business activities---these are provided to creditors at appropriate times. They must also exercise rights that are adequate for protecting the interests of creditors. Standard proposals for all documents, including the trustee's contract, shall be set so that such activities may take root as new customs. They shall also review measures for adjusting the issuing requirements; this is following the addition/removal of special agreement matters on the standard proposal when contract is made between the parties concerned.

9. This Code needs continuous adjustment and revision with the changing circumstances; therefore, related institutions are advised to maintain a cooperative relation that is mutually flexible.

Appendix 1

Members of the Committee on Corporate Governance

- Mr. Jae-Chul Kim (Chairman of the Committee)
Chairman, Korea International Trade Association,
Chairman, Dongwon Group
- Mr. Suk-Jean Kang
President & Country Director, General Electric International
- Mr. Seungyu Kim
President & CEO, Hana Bank
- Mr. Young Moo Kim
Attorney at Law, Kim & Chang Law Offices
- Mr. Jin Man Kim
President & CEO, Hanvit Bank
- Mr. In Ju Kim
President, Korea Merchant Banking Corporation
- Mr. Hyung-Bae Kim
Professor of Law, Korea University
- Mr. Hyung Byun
Chairman & CEO, Korea Investment Trust Company
- Mr. Sang-Mo Sohn
Chairman, Korea Strategic Management Consulting Company
- Mr. Seung-Woo Yang
Office Managing Partner, Anjin & Co.
- Mr. Hogen Oh
Executive Chairman, Corporate Restructuring Coordination Committee

Appendix 2

Members of the Advisory Group

Dr. Woon-Youl Choi (Chairman)

President, Korea Securities Research Institute
Professor of Finance, Sogang University

Mr. Kon Sik Kim

Professor of Law, Seoul National University

Mr. Myung-Hoon Song

Executive Director, Korea Stock Exchange

Mr. Jung-Hwan Oh

Managing Director, Korea Securities Dealers Association

Mr. Han-Soo Yu

Secretary General, The Federation of Korean Industries

Mr. Young Ki Lee

Senior Research Fellow, Korea Development Institute

Mr. Young Sae Lee

Executive Director of the Center for Industrial Policy Study, Korea Institute
for Industrial Economics & Trade

Mr. Chul-Song Lee

Professor of Law, Hanyang University

Dr. Kwang S. Chung

Professor of Finance, Chung-Ang University

Mr. Dong-Yoon Chung

Professor of Law, Korea University

Mr. Young-Tae Joung

Executive Director, Korea Listed Companies Association

Mr. Heungsik Choe

Vice President, Korea Institute of Finance